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No. 08-1437

IN THE
Supreme Court of the United States

TIMOTHY J. RUSSELL AND ANITA L. RUSSELL,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

REPLY BRIEF FOR PETITIONERS

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The Tenth Circuit's decision holds that § 7425(b)(1) of the Internal Revenue Code – which provides that a federal tax lien survives a nonjudicial forcclosure sale in cases where the government does not receive proper notice of the sale – also preempts *post-sale* remedies (here, the Colorado "omitted parties" statute, Colo. Rev. Stat. Ann. § 38-38-506) that allow a good-faith purchaser to cure the notice defect. In so construing the provision, the court created a conflict with decisions of the Ninth and Eleventh Circuits that uphold functionally identical state post-sale remedies. The government would deny the conflict by arguing that the Ninth and Eleventh Circuit decisions are limited to "questions of lien priority," Opp. 9, but that mischaracterizes those decisions, which address the validity of post-sale equitable remedies that allow a purchaser to extinguish a federal tax lien. If such equitable remedies are consistent with federal law – and they are, as discussed below – so is the Colorado statute at issue here.

Review is further warranted because the Tenth Circuit's decision is both wrong and unfair – points that the government hardly contests. The decision is wrong because § 7245(b)(1), by its terms, addresses only the effect of a nonjudicial foreclosure sale made without notice; it does not address the validity of post-sale remedies designed to cure notice defects. Particularly in light of this Court's governing principles of statutory construction – which mandate the preservation of state-law property rules in the absence of a plain conflict – the Tenth Circuit's holding that the Internal Revenue Code "occup[ies] the field" (Pet. App. 10a) is indefensible. And the decision is unfair because it results in a windfall to the government – placing the government in a *better* position

than it would have been in had it received notice of the sale in the first instance, a point the government concedes – and because it leaves innocent parties without any legal remedy to cure a notice defect in an otherwise valid nonjudicial foreclosure sale.

The government does not gainsay the national importance of the issue raised in this petition. This Court should grant the petition and reverse the Tenth Circuit's judgment below.

I. THE DECISION BELOW CONFLICTS WITH DECISIONS OF THE NINTH AND ELEVENTH CIRCUITS

As petitioners explained (at 8-11), the Ninth and Eleventh Circuits each have held that § 7425(b)(1) preserves the government's tax lien when the government does not receive notice of a foreclosure sale, but does not preclude the application of post-sale remedies that lead to discharge of the lien after the notice defect is cured. In particular, those courts have held that "Congress intended *only* to shield the government's junior liens from extinction so the government could protect its interests at a later date," *First Am. Title Ins. Co. v. United States*, 848 F.2d 969, 972 (9th Cir. 1988) (emphasis added), and that, "[i]f any pre-emptive effect was intended by Congress, . . . it is limited to pre-emption of local laws which would completely discharge the government's junior interest without clear notice to the government," *Tompkins v. United States*, 946 F.2d 817, 820 (11th Cir. 1991). By contrast, the Tenth Circuit held that § 7425 "'dictates the method for discharging a tax lien when the underlying property is sold,'" Pet. App. 9a (quoting *Security Pac. Mortgage Corp. v. Choate*, 897 F.2d 1057, 1058 (10th Cir. 1990)), and that "Congress intended federal law to 'occupy the

field'" concerning discharge of federal liens in foreclosure sales, *id.* at 10a (quoting *Crosby v. National Foreign Trade Council*, 530 U.S. 363, 372 (2000)).

The United States offers three responses in an effort to muddy the conflict. None is persuasive.

First, the government suggests (at 9) that the Ninth and Eleventh Circuit cases are distinguishable because they involved a different post-sale remedy from Colorado's omitted-parties statute. In the government's view, the latter "operate[s] to extinguish a federal tax lien," *id.*, while the former does not. To the contrary, the equitable lien remedy that the Ninth and Eleventh Circuits held undisturbed by § 7425 is functionally identical to Colorado's omitted-parties statute. *See* Pet. 13-14. In most states, when a senior lienholder forecloses on property and takes possession at a foreclosure sale, the lien and the title are said to "merge." That is, the "mortgagee's lien is extinguished," and the mortgagee becomes the owner of the property rather than a senior lienholder. *First Am. Title*, 848 F.2d at 971. The equitable lien doctrine "revive[s]" the senior lien for the limited purpose of re-foreclosing the mortgage and terminating any junior interests omitted from the initial foreclosure proceeding. Grant S. Nelson & Dale A. Whitman, *Real Estate Finance Law* § 7.15, at 617 (5th ed. 2007). The omitted junior lienholder in that circumstance may redeem the property or, in the vast majority of cases, see its interest terminated in the re-foreclosure. *See id.* Colorado's omitted-parties statute provides a functionally equivalent remedy: upon discovery of the omitted junior lienholder, the purchaser of the property (or, as in this case, the subsequent purchaser) at foreclosure may bring an action in which the omitted junior lienholder "is

afforded redemption rights." Colo. Rev. Stat. Ann. § 38-38-506(2)(a). If the omitted party chooses not to exercise those rights, its interest is terminated. *See id.*

In each case, the state places the junior and senior lienholders in the same position they were in prior to the foreclosure sale. An equitable lien allows the mortgage to be re-foreclosed, triggering the junior lienholder's statutory right of redemption. *See id.* §§ 38-38-302, 38-38-501. Colorado's omitted-parties statute replicates the redemption right that the junior lienholder would have had if it had been included in the initial sale. *See id.* § 38-38-506(2)(a). The two remedies are thus complementary; indeed, as petitioners pointed out (at 14 n.6), Colorado codifies them in the same statute. *See* Colo. Rev. Stat. Ann. § 38-38-506(2)(a), (b). Commentators similarly discuss the two remedies in tandem. *See, e.g.*, Nelson & Whitman § 7.15, at 616-19.

Second, and relatedly, the government argues (at 9) that *First American Title* and *Tompkins* involved "questions of lien priority" rather than "post-sale remedies that operate to extinguish a federal tax lien." That is incorrect. As described above, the equitable lien doctrine does not merely establish priority among competing lienholders; it revives a lien that had been extinguished for the purpose of terminating a junior interest even after the sale has been completed.

Both the *First American Title* and *Tompkins* courts thus recognized that they were *not* addressing an issue of priority, but rather the question whether § 7425(b)(1) precluded the state from reviving the senior interest. In *First American Title*, the Ninth Circuit expressly noted that, "as to priority issues,

state equitable principles do not apply." 848 F.2d at 972. Instead, the court applied state law because the case "deal[t] with a *property* issue," namely, "whether [the senior] lien survived the sale." *Id.* (emphasis added). Similarly, the *Tompkins* court stated that, "[b]efore we can evaluate the priority of the liens, we must first determine Tompkins' post-foreclosure sale property rights." 946 F.2d at 819. Each court held that § 7425(b)(1) did not preempt the application of state property law to provide an equitable remedy to the senior lienholder – *despite the government's arguments to the contrary*. *See id.* at 820-21; *First Am. Title*, 848 F.2d at 972-73.

Third, the government argues (at 9) that the law of the Tenth Circuit is consistent with that of the Ninth and Eleventh Circuits because the Tenth Circuit previously upheld the application of Colorado's equitable lien doctrine. But, in the decision below, the Tenth Circuit distinguished those prior cases as addressing only the *priority* of liens – that is, the question whether the government's "junior lien was automatically elevated to priority status over another senior lien holder." Pet. App. 12a. As described above, that understanding is incorrect – in fact, the doctrine allows for the revival of an otherwise-extinguished property right precisely for the purpose of curing a defect in notice – and markedly different from the manner in which the Ninth and Eleventh Circuits analyzed the issue. At most, the existence of a prior Tenth Circuit decision suggests the depth of confusion in the law of that circuit; it does not lessen the importance of the conflict.

II. SECTION 7425(b) DOES NOT DISPLACE STATE POST-SALE REMEDIES THAT AFFORD OMITTED JUNIOR LIENHOLDERS THE OPPORTUNITY TO VINDICATE THEIR INTERESTS

A. The government contends (at 6) that § 7425 occupies the field with respect to the disposition of federal tax liens following sales of real property, calling the Tenth Circuit's similar conclusion "correct and unremarkable." But neither the government nor the court below provides *any* support for such a broad scope of federal preemption,[1] which clashes with this Court's principles of statutory interpretation. *See, e.g., Bates v. Dow AgroSciences LLC*, 544 U.S. 431, 441-42 (2005) (noting that "field preemption" applies where a statute is "sufficiently comprehensive . . . to justify an inference that Congress had occupied the field to the exclusion of the States") (internal quotation marks omitted).

B. The government further argues that a conflict arises between 26 U.S.C. § 7425(b)(1) and Colorado Revised Statutes Annotated § 38-38-506(2) because Colorado's statute "'requires extinguishment of the government's lien if it fails to redeem the property,'" while § 7425(b) "'preserves the government's lien.'" Opp. 5 (quoting Pet. App. 11a). There is no such conflict.

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[1] The United States cites *Orme v. United States*, 269 F.3d 991 (9th Cir. 2001), for the proposition that "'Congress has spoken clearly on the divestiture of federal tax liens in sales of property.'" Opp. 6 (quoting *Orme*, 269 F.3d at 994). But the issue in that case was whether § 7425(b) applied at all to the forfeiture of a land sales contract. *See* 269 F.3d at 995-96. The plaintiffs in that case made no argument that any post-sale remedies applied to their title if the government lien remained attached.

1. The government's – and the Tenth Circuit's – analysis is based on a misreading of the statute. As petitioners explained (at 21), § 7425(b)(1) provides that "a sale of property on which the United States has or claims a [tax] lien . . . shall . . . be made subject to and without disturbing such lien" if the government fails to receive timely notice of the sale. 26 U.S.C. § 7425(b)(1). Section 38-38-506(2), on the other hand, provides that "[t]he interest of an omitted party . . . may be terminated if the omitted party, *in a civil action commenced at any time by any interested person* . . . [,] is afforded redemption rights." Colo. Rev. Stat. Ann. § 38-38-506(2)(a) (emphasis added). These two provisions are in no way inconsistent. In this case, for example, the government's lien was *not* extinguished in the unnoticed foreclosure sale. Section 7425(b)(1) was therefore satisfied. Upon discovering the omitted federal tax lien, petitioners brought a subsequent action in which the government was given the opportunity to redeem its interest.[2] Colorado's statute was therefore satisfied. The two remedies are not mutually exclusive.

The claim of conflict depends on reading § 7425(b)(1) to preserve the government's lien *indefinitely* following an unnoticed nonjudicial sale. Indeed, the government argues (at 6) that § 7425(b)(1) not only "prohibits discharge of a federal tax lien . . . at the moment of a nonjudicial sale," but also "bar[s] a State from terminating a federal tax lien thereafter." But § 7425(b)(1) is silent with respect to the *post-sale* remedies that may lead to the extinguishment of federal tax liens that survive unnoticed nonjudicial sales.

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[2] Section 2410 explicitly authorizes such suits. *See* Pet. 19-20. The government does not contest the point.

This Court presumptively applies state law concerning the disposition of federal liens in the absence of *explicit* congressional directive. *See* Pet. 16-18, 21-22. In *United States v. Brosnan*, 363 U.S. 237 (1960) – a case that the government does not even *cite*, let alone discuss – the Court "adopt[ed] as federal law state law governing divestiture of federal tax liens, except to the extent that Congress may have entered the field." *Id.* at 241. That precedent is consistent with the Court's application of a "presumption that state law should be incorporated into federal common law" "in areas in which private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards." *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 98 (1991). The orderly conduct of foreclosure sales is one such area. As the Court noted in *Brosnan*, "when Congress resorted to the use of liens, it came into an area of complex property relationships long since settled and regulated by state law." 363 U.S. at 241-42. "'[T]he security of the titles to real estate'" is "an essential state interest": "the power to ensure that security 'inheres in the very nature of [state] government.'" *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544 (1994) (quoting *American Land Co. v. Zeiss*, 219 U.S. 47, 60 (1911)) (second alteration in original). As the Ninth Circuit held, "Congress intended *only* to shield the government's junior liens from extinction so the government could protect its interests at a later date." *First Am. Title*, 848 F.2d at 972 (emphasis added). The principle underlying Colorado's omitted-parties statute is entirely consistent with that intent.

Finally, the government misreads the legislative history of the Federal Tax Lien Act of 1966. *See* Opp.

7-8. The congressional committee reports highlight Congress's narrow concern with preventing federal tax liens from being "extinguished . . . under circumstances where it is not possible for the [IRS] to take steps to protect the United States in the collection of its tax revenues." S. Rep. No. 89-1708, at 27 (1966), *as reprinted in* 1966 U.S.C.C.A.N. 3722, 3748; *see* Pet. 22. The additional language that the government quotes from that report – that, in nonjudicial foreclosure sales without notice to the government, "the Government's claim continues against the property into the hands of a third party," S. Rep. No. 89-1708, at 28, *as reprinted in* 1966 U.S.C.C.A.N. 3749 – says the same thing. What it does *not* say is that Congress intended to prevent third parties from availing themselves of state-law remedies to clear their titles *after* the unnoticed sale.

Unable to rely on the text or history of § 7425(b)(1), the government argues that a different section of the Internal Revenue Code – § 6322 – preempts state post-sale remedies. Section 6322 provides that a federal tax lien "shall arise at the time the [tax] assessment is made and shall continue until the liability for the amount so assessed . . . is satisfied or becomes unenforceable by reason of lapse of time." 26 U.S.C. § 6322. That provision cannot bear the preemptive weight the government lays on it. Under the government's reading of that provision, a federal tax lien could *never* be discharged until the taxes were paid or the lien became unenforceable. But this Court reached the opposite conclusion in *Brosnan*, holding that "state law" may "govern[] divestiture of federal

tax liens." 363 U.S. at 241.[3] If § 6322 meant what the government claims, Congress's subsequent enactment of § 7425 to prevent government liens from being discharged without notice would have been unnecessary.

2. Finally, the government concedes that it would suffer no prejudice by the application of § 38-38-506 to the tax liens at issue in this case. *See* Opp. 8. Had the United States been included in the foreclosure sale, it would have had to choose between redeeming the property and seeing its interest terminated. *See* Pet. 25; Colo. Rev. Stat. Ann. §§ 38-38-302, 38-38-501. That is the same choice the government faces under the omitted-parties statute. *See id.* § 38-38-506(2)(a). Yet the government argues that it should be placed not in the *same* position as if it had received notice of the sale, but in a *better* position – that is, the government argues that it is entitled to maintain an encumbrance on the property in question *ad infinitum* as a "penalty" for the lack of notice. Opp. 8. But there is *no* indication that Congress intended § 7425(b)(1) to operate as a "penalty" or to provide a windfall for the government. As the government itself concedes (*id.*), the statute was meant simply to "maintain the status quo of [the] lien" following a sale without notice, *Tompkins*, 946 F.2d at 821, so that the government could "protect its interests at a later date," *First Am. Title*, 848 F.2d at 972; *see also United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 729 (1979) (state-law rules are not displaced when they "'furnish [a] convenient solution[] in no way inconsistent with adequate protection of the federal

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[3] Section 6322 was effective in identical form at the time of this Court's decision in *Brosnan*. *See* Internal Revenue Code of 1954, ch. 736, § 6322, 68A Stat. 3, 779.

interest[s]'") (quoting *United States v. Standard Oil Co.*, 332 U.S. 301, 309 (1947)) (third alteration in original). The government's reading turns § 7245(b)(1) into a "gotcha" statute; there is no basis for concluding that Congress intended any such result.

III. THIS CASE PRESENTS AN ISSUE OF UNDISPUTED IMPORTANCE

The United States does not question the national importance of the issue raised in this case. As petitioners and their *amicus* have detailed, it is of critical importance that foreclosure sales be conducted in an efficient and orderly manner, and that the participants in those sales be afforded mechanisms for obtaining free and clear property titles. *See* Pet. 26-27; Br. of American Land Title Ass'n 20-22. By calling into question the application to federal tax liens of numerous states' post-sale remedies for omitted parties to foreclosure sales, the Tenth Circuit has created confusion and uncertainty in national real estate markets. This Court's review is necessary to ensure that those markets continue to function well in this time of significant economic stress.

CONCLUSION

For the foregoing reasons, and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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